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UNCLAS SECTION 01 OF 14 ZAGREB 000046

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KTDB, USTR, HR

SUBJECT: CROATIA 2007 INVESTMENT CLIMATE STATEMENT

REF: 06 STATE 178303

¶1. Summary: Croatia has enjoyed respectable economic growth over the last few years, accompanied by low inflation, a stable exchange rate and growth in the tourism sector. At the same time, the government has undertaken several initiatives aimed at streamlining the bureaucracy in an effort to attract and facilitate foreign investment. Although many challenges still remain, particularly in the legal system, land registries and distorting subsidies to state-owned industries, Croatia has made significant strides in recent years with foreign investors enjoying solid returns in this growing market. Now a candidate for membership in the European Union, Croatia hopes to position itself as a gateway to the markets of South Eastern Europe, capitalizing on its developed infrastructure and favorable geographic position. With the bulk of the country's USD 12 billion in foreign investment since 1991 in the financial and retail sectors, the government's greatest challenge is to attract greenfield investments, particularly export-oriented industries that could help narrow the country's substantial trade deficit. END SUMMARY

A.1 Openness to Foreign Investment

¶2. Croatia is open to foreign investment. The Croatian government has set a goal of increasing foreign investment and continues to undertake measures to improve the investment climate in the country, hoping to build on recent positive trends that include a stable macroeconomic environment and future EU membership. The GoC passed a National Development Strategy that includes plans for economic reform. In 2006, the GoC, with the assistance of USAID, began the Hitro.rez project, which has as its goal the elimination of thousands of laws and regulations that affect business in Croatia. Its managers hope to eliminate 30-50% of existing provisions and simplify another 30-40%. The goal of the project is remove needlessly complex bureaucracy as an obstacle to investment.

¶3. Despite recent progress, however, Croatia still poses challenges for foreign investors. Of these, the greatest is the country's dysfunctional legal system. Although being reformed, the wheels of justice turn slowly in Croatia, with even the

simplest cases taking years to resolve among a backlog of over 1 million pending cases. Although there are laws that govern the sanctity of contracts, the current backlog of cases precludes effective enforcement. The impossibility of obtaining timely judicial remedy in a dispute has hindered investment in Croatia.

¶4. The Government's e-government initiative ?HITRO? (www.hitro.hr) became operational in 2005, with an on-line business registration component that reduces the time it takes to register a company to four days. Business registration is the first step in a plan to make more government services available on-line in coming years and includes the full digitization of Croatia's broken system of land records (see www.pravosudje.hr and www.kataster.hr to find digitized land records).

¶5. The Agency for Trade and Investment Promotion was given new leadership in 2006. The Agency has a mandate to assist potential investors in Croatia, with specialists available in strategic planning, investment support and export support (see www.apiu.hr) and is actively seeking projects that it can promote to foreign investors. The Agency is also active in advising the government on how to make Croatia's regulatory environment more transparent and competitive.

¶6. Croatia's legal framework accords national treatment to foreign and domestic investors. The Internet website of the Croatian Chamber of Economy (www.hgk.hr) provides a useful English-language guide, "How to Start Up an Enterprise in Croatia,"

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as well as sector-specific and general reports. The Zagreb Stock Exchange's website (www.zse.hr) posts English-language translations of key laws in force.

¶7. The Company Act defines the forms of legal organization for domestic and foreign investors. The following are permitted for foreigners: general partnerships, limited partnerships, branches, limited liability companies, and joint stock companies. The Law on Ownership and Other Property Rights permits acquisition/ownership by foreigners with the approval of the Ministry of Justice and on the basis of reciprocity (reciprocity exists with the United States). However, a foreign investor, incorporated as a Croatian legal entity, may acquire/own property without ministry approval. Purchasing by any private party of certain types of land (principally land directly adjacent to the sea or in certain geographically designated areas) can be restricted.

¶8. In privatization, especially of tourism assets along the coast, local governments have occasionally voiced opposition to foreign investment and thrown up barriers to block or limit development, particularly through the non-issuance of construction and use permits.

A.2 Conversion and Transfer Policies

¶9. The Croatian constitution guarantees the free transfer and repatriation of profits and invested capital for foreign investments. Article VI of the U.S. Croatia Bilateral Investment Treaty (BIT) establishes protection for American investors from government exchange controls that limit current and capital account transfers, and limits on inward transfers made by screening authorities. The BIT

obliges both countries to permit all transfers relating to a covered investment to be made freely and without delay into and out of each other's territory. The Croatian Foreign Exchange Law permits foreigners to maintain foreign currency accounts and to make external payments.

¶10. The Foreign Exchange Law also defines foreign direct investment (FDI). For example, use of retained earnings for new investments/acquisitions is considered FDI, whereas investments made by institutional investors such as insurance, pension and investment funds are not considered FDI. The law also liberalizes foreign exchange transactions for Croatian entities and individuals allowing them to invest abroad. Generally, this law liberalized foreign exchange transactions, but it also introduced criteria for the possible imposition of capital controls. The full potential impact of this law and its consistency with investment protection treaties, including the U.S. BIT, is undetermined, and prospective investors should review the legislation carefully.

¶11. The U.S. Embassy in Zagreb has not received any complaints from American companies regarding transfers and remittances.

A.3 Expropriation and Compensation

¶12. There have been no cases of expropriation of foreign investments by the government since Croatia became independent. Article III of the BIT covers both direct and indirect expropriations. The BIT bars all expropriations or nationalizations except those that are for a public purpose, carried out in a non-discriminatory manner, are in accordance with due process of law, and are subject to prompt, adequate and effective compensation.

¶13. Croatian law gives the government broad authority to expropriate property under various economic and security related circumstances. The law provides for an appellate mechanism to challenge expropriation decisions by means of a complaint to the Ministry of Justice within 15 days of the

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expropriation order. The law, however, does not describe the Ministry's adjudication process and the fact that the Ministry of Justice represents the government, which initiates expropriations, is an area of potential concern for investors.

A.4 Dispute Settlement

¶14. Partly because of the low level of U.S. investment in recent years (aside from portfolio investment), there have been few instances of investment disputes involving U.S. companies. As a result of the very long timeframes involved in obtaining judgments in court, it is likely that companies try to resolve disputes informally, often attempting to use political or personal connections. The government is currently working to reduce court backlogs and to encourage the use of alternative dispute settlement.

¶15. The government continues efforts to reform the judiciary, including reducing the backlog of cases, reforming the land registry, training court officers and reducing the backlog and length of bankruptcy procedures. An important move to lessen the backlog of cases is the on-going redistribution of non-

disputed decisions to public notaries. During the past year, the number of pending cases has decreased from 1.64 million to 1.23 million cases. However, the enforcement of judgments still makes up 25% of all pending cases. Although there has been progress in reducing the number of cases, enforcement and execution of judgments remain problematic. According to the provisions of the Law on Enforcement, a judgment made by a judge or panel of judges to order payment or direct actions to be taken or ceased must be executed immediately per such decision. Current practice, however, delays enforcement until all appeals are decided. Article 17 of the Law on Enforcement states that foreign judgments may be executed only if the "judgment fulfills the conditions for recognition and execution as prescribed by an international agreement or the law." The Ministry of Justice's reform plan is available on its website under [e-pravosudje](http://e-pravosudje.hr) at www.pravosudje.hr.

¶16. The Law on Bankruptcy establishes deadlines that force companies to enter bankruptcy proceedings. Bankruptcy and foreclosures have traditionally been slow and inefficient in Croatia. The Ministry of Justice announced in 2005 that streamlining bankruptcy procedures is a priority. The World Bank has estimated that the recovery rate in Croatia is approximately a third of the Organization for Economic Cooperation and Development (OECD) average, and somewhat worse than the regional average.

¶17. The Commercial Court has exclusive jurisdiction over bankruptcy matters. A bankruptcy tribunal decides on initiating formal bankruptcy proceedings, appoints the trustee, reviews creditor complaints, approves the settlement for creditors, and decides on the closing of proceedings. The bankruptcy judge supervises the trustee (who represents the debtor) and the operations of the creditors' committee. A creditors' committee is convened to protect the interests of all creditors during the proceedings, to oversee the trustee's work and to report back to the creditors. The law establishes the priority of creditor claims, assigning higher priority to those related to taxes and revenues of state, local and administration budgets. The law also allows for a debtor or the trustee to petition to reorganize the firm, an alternative aimed at maximizing asset recovery and providing for fair and equitable distribution among all creditors.

¶18. Arbitration is available, if underused. Within the Croatian Chamber of Economy, there is a permanent arbitration court that has been in existence since 1965. Arbitration is voluntary and conforms to United Nations Commission on International Trade Law (UNCITRAL) model procedures.

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The court reviews 30 to 40 cases per year, of which 40% are international cases. There have been five cases of a U.S. company submitting to arbitration in this venue.

¶19. The English-language text of the Law on Arbitration can be found on the website of the Croatian Chamber of Economy (www.hgk.hr). The law covers domestic arbitration, recognition and enforcement of arbitration rulings, jurisdictional matters, and procedures. Once a dispute has been arbitrated the decision is executed upon notice from the court to the obligatory party. If no payment is made by the established deadline, then the party benefiting from the decision notifies the commercial

court and the commercial court becomes responsible for enforcing compliance. Rulings of the arbitration court have the force of a final judgment, but can be appealed within three months.

¶20. Article X of the BIT sets forth several means for resolution of investment disputes, defined as any dispute arising out of or relating to an investment authorization, an investment agreement, or an alleged breach of rights conferred, created, or recognized by the BIT with respect to a covered investment. For more information on the BIT arbitration provisions, see www.mac.doc.gov/Tcc/e-guides/eg_bits (under "Croatia").

¶21. Croatia is a signatory to the following international conventions regulating the mutual acceptance and enforcement of foreign arbitration: the 1923 Geneva Protocol on Arbitration Clauses, the 1927 Geneva Convention on the Execution of Foreign Arbitration Decisions, the 1958 New York Convention on the Acceptance and Execution of Foreign Arbitration Decisions, and the 1961 European Convention on International Business Arbitration. In 1998 Croatia ratified the Washington Convention - the International Center for the Settlement of Investment Disputes (ICSID), and it became effective on October 22, 1998.

¶22. The Croatian constitution provides for an independent judiciary. The judicial system consists of courts of general and specialized jurisdictions, whose core structure is: Supreme Court, County Courts, Municipal Courts, and the Magistrate/Petty Crimes Courts. Specialized courts include the Administrative Court and High Commercial and Lower Commercial Courts. There is also a Constitutional Court that determines the constitutionality of laws and government actions and protects and enforces constitutional rights. Municipal courts exercise original jurisdiction over civil and juvenile/criminal cases. The High Commercial Court is located in Zagreb and has appellate review of lower commercial court decisions. Modification of lower court decisions by the High Commercial Court may be appealed to the Supreme Court.

¶23. The Administrative Court has jurisdiction over the decisions of administrative bodies of all levels of government. The Supreme Court, under certain circumstances, may review decisions. The Supreme Court is the highest court in the country and as such enjoys jurisdiction over all civil and criminal cases. It hears appeals from County, High Commercial, and Administrative Courts.

A.5 Performance Requirements/Incentives

¶24. Croatian law does not impose performance requirements on foreign or domestic investors. Article VII of the BIT prohibits mandating or enforcing specified performance requirements as a condition for the establishment, acquisition, expansion, management, conduct, or operation of a covered investment. The list of prohibited requirements is exhaustive and covers domestic content requirements and domestic purchase preferences, the "balancing" of imports or sales in relation to exports or foreign exchange earnings, requirements to export products or services,

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technology transfer requirements, and requirements relating to the conduct of research and development in the host country. Article VII makes clear,

however, that a party may impose conditions for the receipt or continued receipt of benefits and incentives.

¶25. In late 2004, the Ministries of Economy and Defense agreed to introduce offsets (a requirement for local sourcing of a portion of the contract) for defense procurements over 2 million euros, and the Ministry of Economy said it was looking at introducing offsets in other areas, however no such action has been undertaken.

¶26. As of January 1, 2007, the Investment Promotion Law offers potentially significant incentives (the amount of which is dependent upon the percentage of unemployment in the respective county) to investors, foreign and domestic, such as 1500-3000 EUR incentive per new job position, assistance with retraining and tax incentives. It provides for incentives that apply only to investments in production based businesses, technological development centers and strategic business support activities. The minimum amount of investment that qualifies for incentives is 300,000 EUR. Tax incentives include substantially lower profit tax obligations and customs relief. The text of the law is available on the Croatian National Bank site (www.hnb.hr).

¶27. Incentives include: 10% corporate tax for ten years for companies that invest from 2.2 million to 11 million HRK (approximately \$393,000 - \$2 million) and create 10 new jobs; 7% corporate tax for ten years for companies that invest from 11 million to 30 million HRK (approximately \$2 million to \$5.35 million) and create 30 new jobs; 3% corporate tax for ten years for companies that invest 30 million to 58 million HRK (approximately \$2 million to \$10.4 million) and create 50 new jobs; 0% corporate tax for ten years for companies that invest over 60 million HRK (approximately \$10.7 million) and create at least 75 new jobs.

¶28. Incentive measures refer to investment in the following: new equipment and modern technology, new production processes and new products, greater employment and education of workers, modernization and growth of business, development of production with a higher level processing, an increase in exports, increasing economic activity in regions of Croatia in which economic growth and employment levels lag behind national averages (in accordance with the map of regional areas of special state concern), development of new services, energy conservation, strengthening information technology, cooperation with foreign financial institutions, and harmonizing the Croatian economy with EU standards.

¶29. Investors may also be eligible to receive assistance from the government to offset costs of employee re-training. The government may offer real estate (or permits or infrastructure) to an investment either cost-free or on a preferential basis. Finally, the government will allow the duty-free importation of capital equipment for the investment.

¶30. The Croatian government also offers concessions for business activity carried out in "areas of special state concern" (those areas most affected by the 1991-95 war). Activities in customs free zones are taxed at a lower corporate tax rate and concessions are awarded under the current Law on Free Zones. Also, for a period of ten years from when the Profit Tax Act was enacted in October 2003, no profit tax will be paid for business operations in those FTZs located in the Vukovar and Srijem Counties. However, although still in effect, some

of these incentives are not in compliance with EU standards. The Government is currently studying how to bring them into compliance without renegeing on previously-made commitments. A decision on this is likely in 2007.

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¶31. The Trade and Investment Promotion Agency can be helpful in identifying and applying for investment incentives. Also, the (separate) Office of Investment and Export Promotion in the Ministry of Economy can be helpful in looking for incentive information. Further information can be found on their website at www.mingorp.hr.

¶32. Croatia's WTO Trade Related Investment Measures (TRIMs) agreement went into effect in 2000. Croatia has no trade-related investment measures in place at the present time, nor does the government intend to introduce any such measures in the future. Accordingly, Croatia did not seek to list any measures for elimination under the provisions of the WTO Agreement on TRIMs. Croatia committed to maintaining measures consistent with the TRIMs agreement and has applied the TRIMs agreement from the date of accession without recourse to any transition period.

¶33. Foreign investors will find that the process of obtaining business visas is straightforward. For information on obtaining business and work permits, please contact a Croatian embassy or consulate or visit Embassy Zagreb's website (www.usembassy.hr, see Consular Section, American Citizen Services).

A.6 The Right to Private Ownership and Establishment

¶34. Both foreign and domestic legal entities have the right to establish and own businesses and engage in remunerative activity. Foreign investors can acquire ownership and shares of joint stock companies. The lowest amount of initial capital for establishing a joint stock company is 200,000 HRK (\$36,300) and the nominal value per share cannot be less than 10 HRK (\$1.78). Minimum initial capital for establishment of a limited liabilities company is 20,000 HRK (\$3,571), while individual representation per investor cannot be less than 200 HRK (\$35.71)

¶35. Article 49 of the Constitution provides assurances that all entrepreneurs have equal legal status and that monopolies are forbidden. The Competition Act defines the rules and methods for promoting and protecting competition. This law, and information about the Croatian Competition Agency can be found at www.aztn.hr. In theory, competitive equality is the standard applied to private enterprises in competition with public enterprises with respect to market access, credit and other business operations, such as licenses and supplies. In practice, however, state-owned enterprises and "strategic" firms continue to receive preferential treatment, including government bailouts and subsidies.

A.7 Protection of Property Rights

¶36. The right to ownership of private property is established in the Croatian Constitution and numerous acts and regulations safeguard this right. A foreign physical or legal person incorporated

under Croatian law is considered to be a Croatian legal person. The Law on Ownership and Property Rights establishes procedures for foreigners to acquire property by inheritance as well as legal transactions such as purchases, deeds, and trusts. The right of foreigners to acquire property in Croatia is based on reciprocity. The U.S. and Croatia share reciprocity in this area. Foreign investors, incorporated as a Croatian legal entity, may acquire and own property without restriction. Both Croatian and foreign citizens may mortgage property and pledge real and tangible property.

¶137. In order to acquire property by means other than inheritance or as an incorporated Croatian legal entity, foreign investors require the approval of the Ministry of Justice. Approval often takes

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several months or longer owing to a lengthy interagency clearance process that requires advisory opinions from local authorities. All requests that were awaiting Ministry of Foreign Affairs approval were transferred to the Ministry of Justice as of July 25, 2006 when the Ministry of Foreign Affairs was removed from the approval process.

¶138. Clarifying Croatia's land registry system is an on-going process and while Croatia has made progress resolving a backlog of cases, potential investors should seek a full explanation of land ownership rights before purchasing property. It is highly advisable to seek competent, independent legal advice in this area (see www.usembassy.hr, Consular section for a list of English-speaking attorneys), as there are sometimes ambiguous and conflicting claims to property, making it necessary to verify that the seller possesses clear title to both land and buildings, which can be titled and owned separately. Inheritance laws have led to a situation in which some properties can have dozens of legal owners, some of whom are long since deceased and others of whom emigrated and cannot be found. It is also important to verify the existence of necessary building permits, as some newer structures in coastal areas have been subject to destruction at owner's expense and without compensation for not conforming with local zoning regulations. Investors should be particularly wary of promises that structures built without permits will be regularized retroactively.

¶139. Some aspects of land ownership, as distinct from ownership of objects, are not clear. Investors interested in acquiring companies from the Croatian Privatization Fund should seek expert legal advice to determine whether any deal also includes the right to ownership of the land on which an object is located, or merely the right to lease the land through a concession. The various Croatian laws on privatization are not clear on this point.

¶140. Inconsistent regulations and restrictions on coastal property ownership and construction have in the past provided challenges for foreign investors. Legislation passed in 2004 restricts coastal construction and commercial use within 70 meters of the coastline.

¶141. Croatia has intellectual property rights legislation, including the Patent Law, Trademark Law, Industrial Design Law, Law on the Geographical Indications of Products and Services, Law on the Protection of Layout Design of Integrated Circuits, and Law on Copyrights and Related Rights. Croatia is on the U.S. Special 301 Watch List for failing to

protect U.S. intellectual property rights. The Agency for Medical Products, which is separate from the Patent Agency, does not require license seekers to submit information on existing patents, which has resulted in the past in marketing authorization being given to products that are protected by valid Croatian patents. Problems also exist in the protection of trademarks and copyrights, but at a much lower level.

¶42. As a full WTO member, Croatia is a party to the Uruguay Round Agreement on Trade-Related Intellectual Property Rights (TRIPS). A WTO/TRIPS Working Group in June 2001 accepted Croatia's IPR legislation. Texts of these laws are available on the website of the State Intellectual Property Office: www.dziv.hr. Croatia is also a member of the World Intellectual Property Organization (WIPO). For a list of international conventions to which Croatia is a signatory, consult the State Intellectual Property Office's website.

A.8 Transparency of the Regulatory System

¶43. Together with Croatia's ineffective legal system, a lack of transparency in both business and government has presented one of the greatest challenges to investors. Croatia is under pressure

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to increase transparency and its commitments to adopt EU laws, norms, and practices, provide steady pressure for reform. However, much more progress is needed on this front.

¶44. Bureaucracy is also a major challenge for foreign investors, although the government has made progress in this area, particularly through the development of its e-government initiatives (see paragraph 2). Property registration, for example, has traditionally been notoriously inefficient, sometimes taking up to several years. However, recent reforms and the digitization of the land registers are hopeful signs that this problem will be mitigated in the near future (see paragraph 4). A valuable source of analysis is located on the website of the Croatian office of the World Bank, at www.worldbank.hr. Click on the link for the "Doing Business in Croatia Forum.?

¶45. The regulatory system does not specifically discriminate against foreign investors. However, transparency in developing legislation and regulation is often hampered by an inefficient public administration, a lack of intra-governmental coordination, and reliance on expert advice from national champions, sometimes giving the latter a privileged position in influencing new regulations.

¶46. Tax on corporate income is a flat 20%. There is a 15% tax on interest revenue and royalties. In 2005, tax on dividends was eliminated as a spur to investment. For a detailed description of extant tax legislation, please consult the Tax Administration's website at www.pu.mfin.hr/en. Detailed information about customs can be found at www.carina.hr.

¶47. The Institute of Public Finance maintains a useful table of Croatian taxes at http://www.ijf.hr/eng/taxguide/08_05/taxtable.pdf, and the Ministry of Finance maintains information at www.pu.mfin.hr/en. Croatia also maintains a 22 percent value-added tax (VAT). Some companies have had difficulty with the tax authorities due to

differing understandings of how certain goods and services are affected by the VAT.

A.9 Efficient Capital Markets and Portfolio Investments

¶48. Croatia's capital markets grew strongly in 2006, fueled by the sale of the Government's stakes in Pliva Pharmaceuticals and the national oil company, INA. Typically, Croatian firms have used more debt and less equity financing than comparable U.S. firms.

¶49. In 2006, the amended Investment Fund Law went into force, which provides for the establishment of derivative funds, index funds and other funds in accordance with EU legislation.

¶50. On January 1, 2006, CROSEC (Croatian Securities and Exchange Commission) HAGENA (the Pension Insurance and Fund Supervising Agency), and the Directorate for Supervision of Insurance Agencies merged into one agency called the Agency for Supervision of Financial Services (HANFA), headed by the Directorate for Supervision of Agencies. See www.hanfa.hr for all legislation and information relative to capital markets.

¶51. The privatized and consolidated banking sector is advanced and is becoming more competitive. More than 90% of the total assets of the banking sector are foreign owned. By the end of September 2006, there were 34 commercial banks and five savings banks, whose assets totaled 285 billion HRK (\$51 billion). Italian-owned Zagrebacka Bank (23.11%) and Privredna Bank (17.93%) are the two largest banks per percentage of total bank assets in Croatia.

¶52. Croatia's markets are open to both domestic and
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foreign investment equally. There are no restrictions that would disrupt foreign investment in the securities market and other markets in Croatia. Foreign residents may open non-resident accounts and may do business both domestically and abroad. Article 24 of the Foreign Currency act states that non-residents may subscribe, pay in, purchase or sell securities in the Republic of Croatia in accordance with regulations governing securities transactions. Non-residents and residents are afforded the same treatment in spending and borrowing. These and other non-resident financial activities regarding securities are covered by Articles 24, 25 and 27 of the Foreign Currency Act, which can be viewed on the Central Bank website (www.hnb.hr).

¶53. The government uses the market to finance government expenditure. Government debt instruments must be bought through an intermediary such as a commercial bank, and are tradable on exchanges.

¶54. Currently, securities are traded on the Zagreb Stock Exchange (ZSE), established in 1991, and to a lesser extent on the Varazdin Stock Exchange (VSE), which was established in 1993 as an over-the-counter (OTC) market and registered as a Stock Exchange on July 16, 2002.

¶55. The Securities Law requires that all companies with more than 100 shareholders and with share capital of at least HRK 30 million (approximately \$5.4 million) list on the newly established

quotation for public stock companies (JDD) on one of the two stock exchanges in-country, Zagreb or Varazdin. The intention was to increase transparency and encourage companies to obtain low cost equity financing, which would result in increased turnover and trade volumes.

¶156. All Croatian workers under age 40 are required to pay five percent of their gross salary into a pension fund of their choice. EU Pillar III (additional voluntary savings with government matching of 25%) has also been introduced. Croatian financial markets are benefiting from this infusion of capital.

¶157. Transactions on the Zagreb Stock Exchange in 2005 were 34.2 billion HRK (approximately \$6.1 billion), of which 25 billion HRK (approximately \$4.5 billion) was in institutional turnover. As of December 2006, transactions totaled 45.3 billion HRK (approximately \$8.1 billion) of which 29.4 billion HRK (approximately \$5.3 billion) was institutional turnover. In 2005, transactions on the Varazdin Stock Exchange totaled 2.2 billion HRK (approximately \$390 million) and in 2006 transactions totaled 3.7 billion HRK (approximately \$660 million).

¶158. There are three tiers of securities traded on the ZSE. Companies must meet high disclosure and operating requirements to be fully listed (quotation I). A detailed explanation of all requirements is provided at www.zse.hr in English.

¶159. The Croatian Chamber of Economy provides a useful summary of the capital markets in Croatia at: www.hgk.hr.

A.10 Political Violence

¶160. Political violence is low in Croatia. In late 1995, the conclusion of the Erdut Agreement and the Dayton Peace Accords ended the wars on Croatian territory that followed the break-up of Yugoslavia. In May 2002, Croatia was accepted into NATO's Membership Action Plan, underscoring the improved relationship between Croatia and the international community. Full NATO membership for Croatia is likely before the end of the decade. In October 2005, the European Union began accession negotiations with Croatia in order to prepare Croatia for membership. Relations with neighbors

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have improved steadily in the last few years, and minority parties are represented in the current ruling coalition.

¶161. There is little domestic anti-American sentiment. There have been no incidents involving politically motivated damage to American projects and/or installations in Croatia.

A.11.a Corruption

¶162. Although Croatia is not a uniquely corrupt country, corruption is still a problem and is perceived to be widespread. In the 2006 Corruption Perception Index survey compiled by Transparency International (TI), an international watchdog organization for corruption, Croatia received an index score of 3.4 out of 10 (ten being "highly clean"), remaining unchanged from 2005.

¶63. In March 2006, the government presented its National Strategy for Battling Corruption and Organized Crime (Strategy) that proposed to overhaul the judicial system, health system, local government, political party financing, public administration, and the economy. Most observers consider that corruption is a problem of opportunity and that continued reforms of the bureaucracy and judiciary, combined with pressure from the international business community and the EU will result in greater transparency and accountability. While Croatia has undertaken the guidelines set by the Strategy, the European Commission, in its "Croatia 2006 Progress Report," issued November 2006, stated that corruption and a flawed judicial system were still the greatest problems the country faced.

¶64. Croatia has ratified the Council of Europe Criminal Law Convention on Corruption, the Council of Europe Civil Law Convention on Corruption, the United Nations Convention Against Transnational Organized Crime and the United Nations Convention Against Corruption.

¶65. Croatia is a member of GRECO (the Group of States Against Corruption), a peer monitoring organization that allows members to assess anticorruption efforts on a continuing basis. An evaluation of Croatia including suggestions and opinions on Croatia's progress in its fight against corruption, can be found on GRECO's website (www.greco.coe.int).

¶66. The Office for the Prevention of Corruption and Organized Crime (USKOK) is currently staffed by 36 employees (doubled from 2005) and participates in joint task forces with the Ministry of Finance and Police. In 2006, a couple of high profile cases of alleged corruption came under investigation, but none have yet resulted in conviction. In order to secure success of the Strategy (see paragraph 66), the government will have to enforce cooperation between Ministries and ensure financial as well as human resources. The U.S. and EU are working with Croatian authorities to build capacity to fight organized crime and corruption.

A.11.b Bilateral Investment Agreements

¶67. Croatia does not have a foreign investment law; foreigners receive national treatment under existing legislation. In addition, investments by American citizens are covered by the U.S. Croatian Bilateral Investment Treaty (BIT), which entered into force in June 2001. The treaty fulfills the principal U.S. objectives for agreements of this type:

-- All forms of U.S. investment in the territory of Croatia are covered;

-- Covered investments receive the better of national treatment or most-favored-nation (MFN) treatment, both while they are being established and

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thereafter, subject to certain specified exceptions;

-- Specified performance requirements may not be imposed upon or enforced against covered investments;

-- Expropriation is permitted only in accordance with customary international law standards;

-- Parties are obligated to permit the transfer, in a freely usable currency, of all funds related to a covered investment, subject to exceptions for specified purposes;

-- Investment disputes with the host government may be brought by investors, or by their covered investments, to binding international arbitration as an alternative to domestic courts.

¶68. For further information about BITs and for the text of the U.S.-Croatian BIT please see www.mac.doc.gov/Tcc/e-guides/eg_bits (under "Croatia").

¶69. Croatia has signed investment protection treaties/agreements with the following countries, however, not all have entered into force:

Albania, Argentina, Austria, Belgium, Belarus**, Bulgaria, Bosnia and Herzegovina, Czech Republic*, Chile, Denmark, Egypt, Finland, France, Greece, Germany, India, Indonesia**, Iran*, Italy, Israel*, Jordan, Kuwait, Cambodia, Canada, Qatar*, China*, Cuba**, Latvia**, Libya**, Hungary, Macedonia*, Malaysia*, Malta, Republic of Moldova**, Netherlands, Oman**, Poland, Portugal, Romania, Russia*, United States, Serbia Montenegro, Slovakia, Slovenia**, Spain, Sweden, Switzerland*, Thailand*, Turkey, United Kingdom, Ukraine, Zimbabwe*. (* = ratified, but not in force) (** = not ratified or in force)

A.11.c OPIC and Other Investment Insurance Programs

¶70. Croatia is eligible for coverage from the U.S. Overseas Private Investment Corporation (OPIC). For more information on OPIC's insurance activities, see www.opic.gov. The OPIC-supported \$200 million Bedminster Investment Capital Management Fund invested in the Croatian banking sector (as part of the consortium that purchased Dubrovacka Banka) and the Croatian communications sector (by investing in Digital City Media, a broadband cable TV network in Croatia). Bedminster Capital Management also manages an OPIC-supported private equity fund -- Southeast Europe Private Equity II -- which targets investments in Croatia, among other countries. Croatia is a member country of the Multilateral Investment Guarantee Agency (MIGA), for more information see www.miga.org.

¶71. In the event that OPIC should pay an inconvertibility claim under its political risk coverage, the local currency accepted by OPIC in any subsequent recovery would be made available to the Embassy on a priority basis for U.S. Government expenses. The estimated annual U.S. dollar value of local currency used by the Embassy is approximately \$13.5 million. The Embassy currently purchases local currency from a local commercial bank at the market rate. A major devaluation is unlikely.

A.11.d Labor

¶72. Croatia has an educated, highly-skilled, and relatively high cost labor force compared with the region. In general, employerQs wage costs are approximately 110% of an employeeQs net wage. The estimated average cost to employers in Croatia was 7,713 HRK (approximately \$1,377) per month as of October 2006. The average net wage at the end of the third quarter of 2006 was 4,585 HRK (\$818). Minimum wage, as determined by the government, is 2100 HRK gross (\$375) monthly, net is between 1400-

1500 HRK (\$250-\$267) depending upon exemptions. The Croatian government controls wage levels in government agencies/institutions and in the remaining state-owned enterprises, affecting around half of all workers. The wages in privately owned companies are freely determined by contracts between employer and employee.

¶ 73. Croatia adopted new labor laws in mid-2003 aimed at increasing labor market flexibility by shortening the mandatory notification period before dismissal and reducing generous severance package requirements. However, Croatia still fares badly in terms of time and expense in hiring and firing employees. Labor has generally been supportive of government efforts to boost competitiveness and welcomes foreign investment but remains concerned about any possible cuts in social spending.

¶ 74. The Law on Labor regulates employee and employer relations through "employment contracts." Fulltime employment must not amount to more than 40 hours per week and employees are entitled to at least 18 working days of paid annual leave and seven days of personal leave. The Law on Labor also provides special protections for workers in dangerous occupations, work at night, and work by minors between the ages of 15 and 18.

¶ 75. Article 87 of the Law on Foreigners covers the issuance of work permits. While there are quotas (determined annually) for work permits, there are no quotas for foreigners who execute key positions in companies or representative offices. Likewise, there are no quotas for business visas.

¶ 76. Workers are entitled by law to form or join unions of their own choosing, and workers exercised this right in practice. In general, unions were independent of the government and political parties. The Labor Code prohibits anti-union discrimination and expressly allows unions to challenge firings in court; however, in general, attempts to seek redress through the legal system were seriously hampered by the inefficiency of the court system.

A.11.e Foreign Trade Zones/Free Ports

¶ 77. Croatia has several Free Trade Zones (FTZs), some in war-affected areas. Special incentives are offered to users of FTZs.

¶ 78. The Law on Free Trade Zones allows a foreign-owned or domestic company in FTZs to engage in manufacturing, wholesale but not retail trade, foreign trade, banking and other financial activities. The Law on Profit Tax also covers business in FTZs. FTZ users are eligible for tariff waivers on imported products. FTZ users who construct or participate in construction of infrastructure projects worth 1 million HRK (about \$178,000) or more in the zone, are exempted from paying corporate tax during the first five years of operation in the zone. Other users in the zone pay corporate tax in the amount of 50% of the regular rate (i.e., 10% instead of 20%).

¶ 79. FTZs are exempted from any Croatian emergency measures or other restrictions pertaining to foreign trade or hard currency transactions. Users of the zones may freely store their goods and production equipment in the zones. Goods that are not intended for trade on the Croatian market or for domestic consumption are fully exempt from custom duties or

taxes. Imported goods will be taxed and assessed duties per the value of the production materials imported for the product and not per the value of the finished product.

¶80. The following fifteen counties currently have FTZS: Buje, Krapina-Zagorje, Osijek, Rijeka, Slavonski Brod, Split, Splitsko-Dalmatinska County, Obrovac, Ploce, Pula, Kukuljanovo, Varazdin, Zagreb, Vukovar, and Ribnik counties. As mentioned previously, EU accession will force the Government

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to make changes in the free trade zone system and the incentives system associated with them.

A.11.f Foreign Direct Investment Statistics

¶81. Compared to other advanced transitional economies in the region, Croatia is in the middle group in terms of foreign direct investment (FDI). New or green-field investments have seen particularly slow growth. According to the Trade and Investment Promotion Agency, there were 18 foreign investment projects initiated this year. Privatization of strategic government-owned assets has been the main source of FDI since Croatian independence. Large state assets such as utilities, the state insurance company and banks, are being sold by the government, usually through international tenders, and in some cases, with specific laws regulating the sale of each enterprise (e.g., the oil company and the electric company). The Croatian Privatization Fund, the agency responsible for the sale of other assets, has shares and stock in 1012 (mostly non-performing) companies. These include hotels, integrated agricultural companies, an aluminum plant, two steel plants, shipyards and other companies. The state's share of the equity base value of these companies is about 11.524 billion HRK (\$2.06 billion). Information regarding the Croatian Privatization Fund, including information on companies currently for sale, can be found on its website, www.hfp.hr.

¶82. In November 2006, the GOC as part of its privatization efforts, offered to the public first rights for 15 per cent of their INA holdings. Individual purchase was limited to 38,000 HRK (\$6,785) and included the offer of one free share for every ten retained for at least a year. 44,271 citizen participated in this unprecedented offer and purchased shares at the cost of 1,690 HRK (\$301) each.

¶83. Foreign Direct Investment between 1993 and the third quarter of 2006 totaled \$13.15 billion, with investments in the financial and telecommunications sectors accounting for 40% of the total. FDI in Croatia has shown steady growth in recent years.

¶84. Austria is the largest source of foreign investment in Croatia, accounting for 22% of total FDI since 1993. Germany is second with 16% of total FDI, followed by France with 8.8% and the United States with 8.6%. Croatian firms invested \$1.8 billion abroad between 1993 and the third quarter of ¶2006. The leading destinations for Croatian investment were Switzerland, Bosnia and Herzegovina, and Serbia and Montenegro. In the first three quarters of 2006, Croatians invested \$98million abroad: approximately 38% in Switzerland, 16% in Bosnia-Hercegovina, 15% in Serbia and Montenegro and 8% in Poland.

¶85. The Croatian National Bank provides information about foreign investments in aggregate form which can be found on their website at www.hnb.hr. The following is a list of some of the major (\$20 million and above) foreign investments in Croatia to date:

Foreign investor: Barr Pharmaceuticals
Sector: pharmaceuticals
Croatian company: Pliva
Value \$2.3 billion

Foreign investor: Deutsche Telekom (Germany)
Sector: telecommunications
Croatian Company: Croatian Telecom (51% of shares)
Value: \$1.272 billion

Foreign investor: MOL (Hungary)
Sector: Oil Industry
Croatian Company: INA d.d. (26% of shares)
Value: \$505 million

Banca Commerciale Italiana (Italy)

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Banking/financial services
Privredna Banka (66.66% of shares in 1999 plus 10% in 2002)
Value: \$300 million + approximately \$50 million, according to media reports

Unicredito Italiano (Italy)
Banking/financial services
Zagrebacka Banka (96% ownership)
Value: \$230 million (estimate)

Erste und Steiermarkische Bank (Austria)
Banking/financial services
Rijecka Banka (85% share)
Value: \$155 million

Austria Creditanstalt Group (HVB Group) (Austria)
Banking/financial services
Splitska Banka (88% ownership)
Value: \$132 million

Heineken N.V. (Netherlands)
Brewery
Karlovacka Pivovara company (94.42%)
Value: \$125 million

Sutivan Investment and Excelsa Anstalt (Lichtenstein)
Hotels and tourism
Plava Laguna (81.5%)
Value: \$70 million

Ericsson (Sweden)
Telecommunications
Tesla Company
\$48 million

Hofmann and Pankl Betelligungasse (Austria)
Minerals processing
Straza Company
\$39 million

Societe Suisse de Cement Portland (Switzerland)
Cement
Tvornica Cementa Koromacno company
\$38 million

Interbrew (Belgium)
Brewery
Zagrebacka Pivovara company
\$27 million

Coca Cola Amatil (Australia)

Non-alcoholic beverages

Croatian company: n/a

\$20 million

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